U S WEST wholeheartedly agrees with the observations of one CMRS provider that the flexibility afforded by negotiations "has served the [CMRS] industry well, resulting in more diversity between competing systems and lower interconnection charges."[16]

3. Negotiations Have Allowed U S WEST to Introduce New Services to the Financial Benefit of CMRS Providers

U S WEST has recently introduced two innovative pricing plans — calling party pays and wide area calling — that have proved to be very popular and financially attractive to CMRS providers.

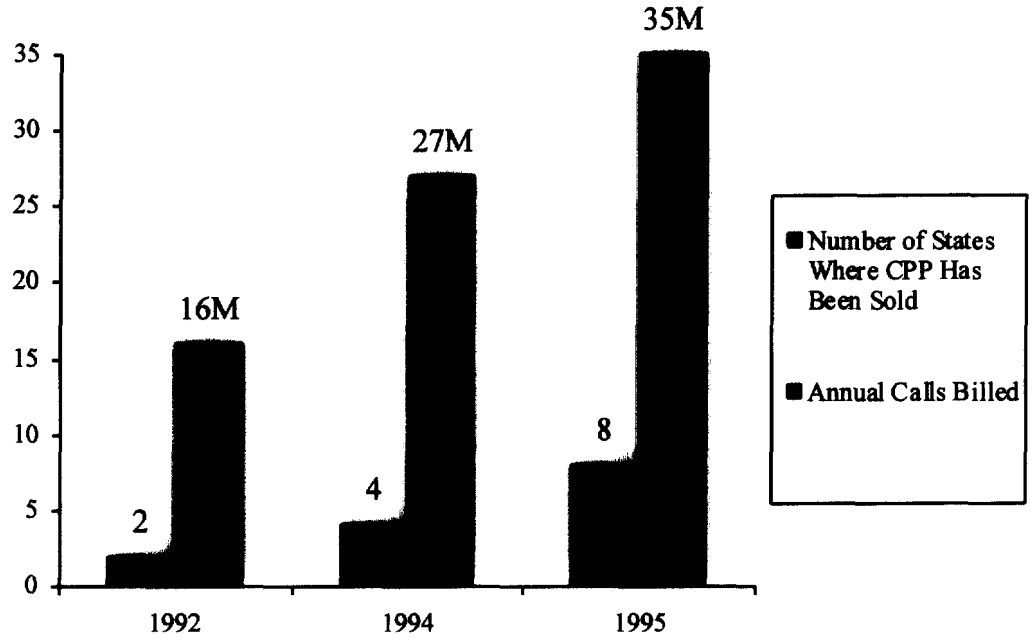
(a) Calling Party Pays. Calling Party Pays ("CPP") is an optional service arrangement in which landline customers pay the entire cost of a call — including airtime — made to a CMRS customer. CPP generally works as follows: a CMRS provider bills its customers its regular monthly service fee as well as a special monthly CPP plan fee. U S WEST bills its landline customers originating CPP calls a per-minute charge specified by the CMRS provider. This CPP charge covers U S WEST's billing and collection charge plus the airtime charges specified by the CMRS provider.[17] U S WEST then remits to the CMRS provider the airtime charges specified by the CMRS provider — often set at a premium level.

[16] AirTouch Comments, Docket No. 94-54, at 21 (Sept. 12, 1994).

[17] Because CPP calls involve toll-like charges, U S WEST requires its customers to dial a "1" before the seven-digit CMRS number which results in callers being advised of the special charges.

U S WEST's CPP service has proven to be very popular among CMRS providers, as the following table documents:

Growth in U S WEST's CPP Service



Paging companies and new broadband CMRS licensees have expressed strong interest in U S WEST's CPP service. Paging companies like CPP because it allows them to introduce per-call, usage-based pricing in their services. New licensees and paging companies like CPP because it allows them to broaden their market penetration by having call originators pay to contact their subscribers.

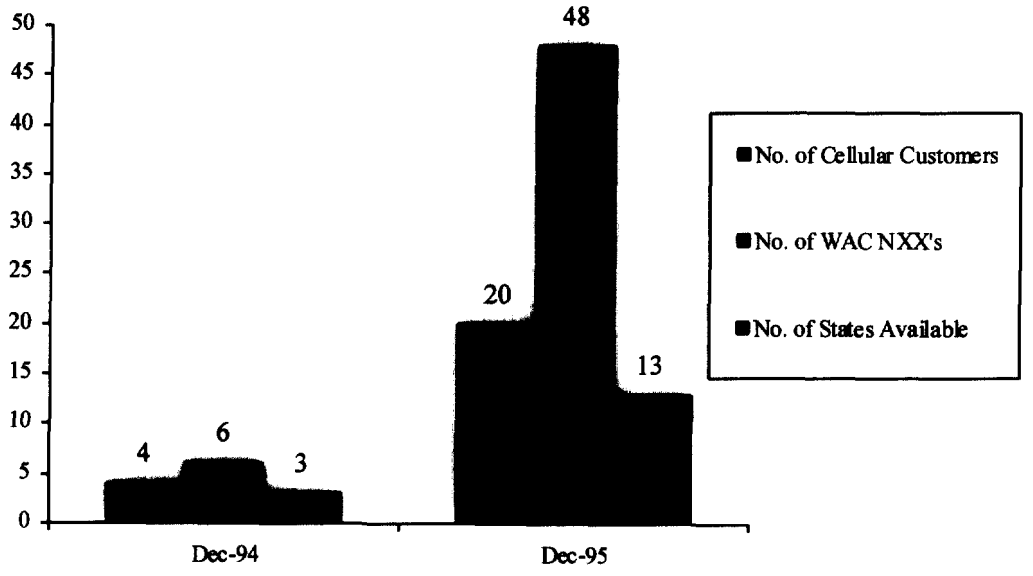
(b) Wide Area Calling. Wide Area Calling ("WAC") works much like 800 service in that it allows landline callers to reach the CMRS subscriber without incurring toll

charges.[18] WAC also reduces a CMRS provider's costs because that provider requires fewer points of interconnection with this service.

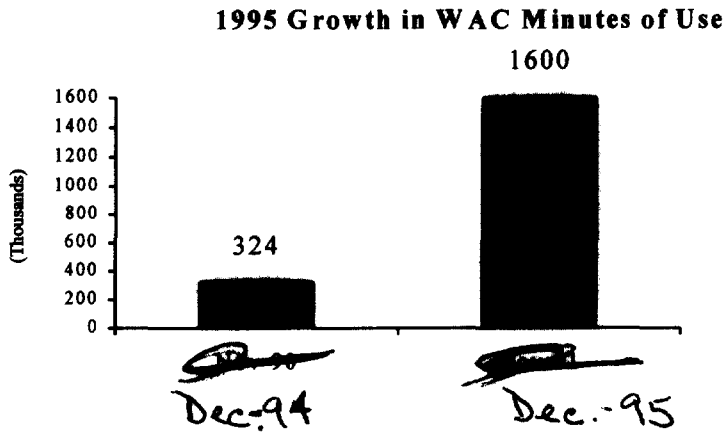
In making a WAC call to a CMRS subscriber, landline callers pay no toll charges and often must dial only seven digits (rather than 11 digits). CMRS providers pay U S WEST a discounted rate for toll and have the option of recovering this discounted rate from their own customers.

Like Calling Party Pays, Wide Area Calling has been eminently successful and will further stimulate CMRS growth:

1995 Growth in U S WEST's WAC Service



[18] U S WEST introduced WAC in 1992 in response to requests of CMRS providers and, based upon additional CMRS input, WAC was re-defined and rolled out across U S WEST's service area in 1995.



Other new services and features include the introduction of Type 2S — SS7 interconnection — which U S WEST has made available to CMRS providers with no additional usage charges.

C. Fact vs. Fiction: the Undocumented Assertions of Certain CMRS Providers

In recent months, certain CMRS providers have begun making new allegations against the LEC industry. Specifically, they allege that current interconnection charges preclude them from competing with local landline exchange services and that LECs have supposedly violated the Commission's mutual compensation rules. These charges are baseless, as demonstrated below.

1. Interconnection Charges Are Not a Barrier to Increased Local Competition

The CMRS industry has contended recently that the current level of CMRS interconnection charges acts to restrain competition in the local loop:

> [Local] competition cannot be fully realized under the current regulatory reality. The wireless industry cannot compete to provide local service if the typical wireline consumer using 1200 minutes per month (and paying approximately $25) must pay the LEC $36.00 just for wireless access charges.[19]

This undocumented assertion is pure fiction. The fact is that a CMRS provider would pay U S WEST ***less than $2.00*** — not $36.00 — to terminate the calls of its "typical" wireline customer.[20]

In U S WEST's service territory, the "typical" residential customer originates 97 minutes of local calls a month — not 1,200 minutes as asserted by CTIA.[21] This 97-minute figure includes all local calls (*i.e.,* those made to customers served by independent telephone companies and CMRS providers). U S WEST estimates that roughly 90% of all local call attempts are made to other U S WEST customers (as opposed to customers

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[19] Letter from Thomas E. Wheeler, CTIA President, to Hon. Reed E. Hundt, FCC Chairman, at 2 (Nov. 20, 1995).

[20] CTIA does not explain how it arrived at its figure of "1200 minutes per month," but this figure appears to include both originating and terminating minutes. The inclusion of minutes which would terminate on a CMRS system is erroneous because, contrary to the assertions of certain CMRS providers, U S WEST does not charge CMRS providers to terminate land-to-mobile calls.

[21] Within the 14-state service area of U S WEST's LEC, the median number of minutes originated by a residential customer is 97 minutes per month (from a low of 67 minutes in Wyoming to a high of 133 minutes in Utah. The mean (or average) number of minutes originated by U S WEST's residential customers overall is 488 minutes (further confirming that a relatively small number of customers originate most calls).

served by other carriers). Consequently, it is reasonable to assume that the "typical" residential customer originates approximately 88 local minutes monthly to another U S WEST customer.

As noted, the effective rate U S WEST charges for the most common interconnection arrangement (Type 2A-tandem) is 2.26¢ per minute.[22] Consequently, if a CMRS provider were to serve a "typical" U S WEST residential customer using the most common interconnection arrangement, the CMRS provider would pay U S WEST only $1.99 each month (88 originating minutes x $0.0226 per minute). There is, therefore, absolutely **no** basis for CTIA's assertion that CMRS providers would pay U S WEST $36 per month if they were to serve "the typical wireline consumer."

Under no circumstances can it be said that U S WEST's interconnection charges impede the ability of CMRS providers to compete in the local loop. The reality is that interconnection charges represent a small percentage of a CMRS provider's total revenues — ***something less than 3%!***[23]

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[22] Approximately 92% of all cellular minutes traversing U S WEST's network use Type 2A tandem interconnection arrangements, as opposed to the cheaper Type 2B end office arrangements.

[23] Assume a CMRS customer originates and terminates 100 minutes of calls in a given month. U S WEST believes that CMRS providers charge, on average, 35¢ per minute for airtime in addition to a monthly service fee. (However, according to a 1994 MTA/EMCI study, cellular carriers charge on average 44¢ per retail minute for airtime.) This would result in a monthly airtime bill of $35.00 for this CMRS customer. Assume further that this CMRS customer has the typical mix of originating and terminating traffic: 70% mobile-to-land, 25% land-to-mobile, and 5% mobile-to-mobile. The CMRS provider would pay U S WEST only for the 70 minutes of mobile-to-land traffic. At U S WEST's effective rate for Type 2A interconnection ($0.0226), the CMRS provider would pay U S WEST only $1.58 for these 70 minutes — or 4.5% of the $35.00 in airtime revenues the CMRS provider receives. Assuming a monthly service fee of $25.00 in addition to the airtime charges of $35.00, U S WEST's interconnection charges would constitute less than 2.7%. Of course, CMRS providers would pay U S WEST even less if their airtime minutes traversed Type 2B trunks (with its effective rate of $0.0191).

The further reality is that both the CMRS industry and the Commission have acknowledged that landline and CMRS services do not meaningfully compete today and will not meaningfully compete in the near future. As the largest CMRS provider acknowledged only months ago:

> AT&T believes that although at some time in the future wireline and wireless services might compete, they do not compete now.[24]

This Commission similarly advised Congress only six months ago that it is only "conjecture" whether "wireless services can eventually compete with wireline telephone service."[25]

There are many reasons why landline and CMRS services do not currently compete meaningfully with each other.[26] A major reason is the price charged to consumers. U S WEST's local residential service is priced, on average, about $14 to $15 per month.

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[24] AT&T Reply, Docket No. 94-54, at 5 (July 14, 1995). *See also* AirTouch Comments, Docket No. 94-54, at 4 (June 14, 1995)("[G]iven the differences in price and use, wireline and wireless services are not generally substitutes today in the consumer market."); AT&T Comments, Docket No. 94-54, at 10 (June 14, 1995)("Cellular service . . . and landline services may sometime in the future compete in the same market. Because local landline telephone service is generally priced below cost, however, local landline telephone service does not currently compete in the same market as CMRS.").

[25] Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services, First Report, 10 FCC Rcd 8844, 8869 at ¶ 75 (Aug. 18, 1995).

[26] Many of the reasons are discussed in Michael J. Marcus & Thomas C. Spavins, The Impact of Technical Change on the Structure of the Local Exchange and the Pricing of Exchange Access: An Interim Assessment, at 20-26 (1993).

This is a rate that, as the CMRS industry readily admits, is "priced below cost,"[27] and this is a rate which U S WEST has little flexibility to increase (because of state regulation).[28]

In contrast, CMRS providers face no regulatory constraints in pricing their services. They charge their average customers between $57.04 and $110.77 monthly for CMRS service[29] — a rate which includes "a significant premium."[30] Cellular service, the Commission further observed, "is a highly profitable business in large cities" and that "[m]any firms, especially ones serving large metropolitan areas, are earning economic rents of significant proportions."[31] Consequently, the Commission has noted that CMRS providers will not become effective competitors in the local loop until there are major changes in the prices for landline and CMRS services:

> It therefore appears that wireless telephone service prices will have to fall well over fifty percent (or that wireline prices will have to rise to meet them) for wireless service to be fully price-competitive with traditional wireline telephone service.[32]

Until the two cellular carriers face more competition, they will have no incentive to compete in the local landline loop. As two Commission staff members have noted,

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[27] *See* AT&T Comments, Docket 94-54, at 10 (June 14, 1995).

[28] The greatest single barrier to increased wireless/landline competition is the continued imposition of below-cost rates on basic residential service. The way to remove this barrier is for regulators to give incumbent LECs the flexibility to raise these rates to cover their costs.

[29] *See* Table 8, "Cellular Prices for 160 Minutes in 29 Top Markets," Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services, First Report, 10 FCC Rcd 8844, 8883 (Aug. 18, 1995).

[30] Id. at 8869 ¶ 75.

[31] Id. at 8853 ¶ 28 and 8871 ¶ 81.

[32] Id. at 8869-70 ¶ 75.

"[t]he demand for mobile telecommunications is so great in most urban and suburban locations that the two cellular carriers do not need to look to landline substitution as a part of their market."[33]

Moreover, as evidenced by the recent entry of Sprint PCS in the Washington D.C. market, early indications are that most PCS licensees intend to compete against cellular carriers for the lucrative mobile traffic rather than provide a competitive alternative to the local loop. This is understandable given that cellular carriers are earning "economic rents of significant proportions" while landline residential service is "priced below cost."

There is, therefore, absolutely no basis for the Commission's apparent "concern[] that existing general interconnection policies may not do enough to encourage the development of CMRS, especially in competition to LEC-provided wireline service."[34] And, given the fact that U S WEST's interconnection charges represent less than 3% of a CMRS provider's revenues, there is absolutely no basis for the assertion that LECs have the ability "to control the fate" of the CMRS industry.[35]

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[33] Michael J. Marcus & Thomas C. Spavins, The Impact of Technical Change on the Structure of the Local Exchange and the Pricing of Exchange Access: An Interim Assessment, at 22 n.41 (1993).

[34] Notice at 1 ¶ 2.

[35] Letter from Brian D. Kidney, AirTouch Communications, Joseph W. Wax, Jr., Comcast Corporation, Alexander V. Netchvolodoff, Cox Enterprises, to Hon. Reed Hundt, FCC Chairman, at 1 (Jan. 18, 1996). The Commission seeks comment on "the reasons for the imbalance of traffic flowing between LECs and CMRS providers." Notice at 21 ¶ 41. It is clear that LEC Type 2 charges are not the reason. Rather, because CMRS providers include "a significant premium" in their service charges, CMRS subscribers often do not want to receive unsolicited calls. It is therefore not surprising that so few CMRS subscribers publish their CMRS number in local public directories.

2. The Phantom Mutual Compensation "Violation"

Certain CMRS providers have complained to the Commission that LECs have violated the Commission's rule to pay mutual compensation, and the Commission appears to have accepted this undocumented assertion at face value.[36] This complaint, made by only a handful of CMRS providers, has no merit whatsoever.

It bears remembering at the outset that the Commission's mutual compensation rule applies to interstate traffic only. In this regard, the Commission reaffirmed only last year that it has no jurisdiction over LEC-CMRS intrastate traffic.[37]

U S WEST has expressed its willingness to discuss mutual compensation *if* the CMRS provider was willing to report interstate traffic. Although it is generally understood that CMRS providers handle some interstate traffic, not once during the past decade has a single CMRS provider reported interstate traffic to U S WEST.[38]

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[36] *See, e.g.,* Notice at 8 ¶ 14, 14-15 ¶¶ 26-28, and 38 ¶ 81. Notably, while these few CMRS providers freely make this generalized complaint, they have never filed a formal complaint against any LEC for violating the mutual compensation rule. Does the Commission really believe that these powerful corporations, with their talented lawyers, would not file formal complaints if they suspected that one or more LECs were violating a Commission rule?

[37] *See, e.g.,* Louisiana Rate Petition Order, 10 FCC Rcd 7898, 7908 at ¶ 47 (1995); Second CMRS Report, 9 FCC Rcd 1411, 1498 at ¶ 231 (1994); Indianapolis Telephone v. Indiana Bell, 1 FCC Rcd 228 (1986), *aff'd,* 2 FCC Rcd 2893 (1987)(dismissing complaint involving only intrastate interconnection charges).

[38] The reason CMRS providers claim no interstate traffic is understandable. If they report interstate traffic, LECs would charge interstate access charges. *See* FCC Policy Statement on Interconnection of Cellular Systems, 59 R.R.2d 1283, 1284-85 n.3 (1986)("[W]here a cellular company is offering interstate, interexchange service, the local telephone company providing interconnection is providing exchange access to an interexchange carrier and may expect to be paid the appropriate access charge."). CMRS providers have obviously decided they would prefer to pay Type 2 interconnection charges than receive mutual compensation and pay interstate access charges.

CMRS providers also complain about the absence of mutual compensation in state jurisdictions. This is a red herring because, over the past decade in U S WEST's 14 states, only one CMRS provider (affiliated with an independent telephone company) ever filed a complaint about the absence of mutual compensation.[39]

The issue of mutual compensation for the exchange of intrastate traffic is now academic. This is because the Telecommunications Act of 1996 requires mutual compensation for all new interconnection arrangements between co-carriers. New Section 252(d)(2) that new interconnection agreements "provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier."[40]

However, the Commission should be aware that, had free market forces been allowed to operate, mutual compensation for LEC-CMRS traffic would have likely been inevitable. As one prominent CMRS provider has stated:

> [C]ellular carriers have not yet obtained mutual compensation agreements with LECs, but such agreements are likely to be made as a result of future negotiations.[41]

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[39] *See* Union Telephone v. Wyoming Public Service Comm'n, 833 P.2d 473 (Wyo. 1992). *See also* U S WEST Communications, No. 95-7, Wyoming Supreme Court (Nov. 16, 1995). In return for receiving mutual compensation, the Wyoming Commission held that the CMRS provider should pay U S WEST's intrastate access charges rather than its Type 2 charges.

[40] The new Act does not disturb existing LEC-CMRS contracts negotiated in good faith.

[41] AirTouch Comments, Docket No. 94-54, at 7-8 (June 14, 1995).

D. The Most Telling Point: the Absence of Complaints

CMRS providers have always recognized that the Commission's "formal complaint process remains available to a CMRS provider that has difficulty obtaining a good faith agreement. Alternatively, that provider may seek Commission staff's informal participation in ongoing negotiations."[42] These procedures, one CMRS association has stated, "can sufficiently protect CMRS providers against unreasonable discrimination practices by the LECs."[43]

CMRS providers readily acknowledge that they are "sophisticated buyers of access services with sufficient information and expertise to negotiate equitable interconnection arrangements."[44] They also have ready access to able lawyers, as the number and quality of comments they have filed in this proceeding attest. If LEC interconnection arrangements were truly as unreasonable as some CMRS providers now contend, why, then, have so few complaints been filed with this Commission or state commissions?

Complaints have not been filed because current LEC-CMRS interconnection arrangements are reasonable. Indeed, as one CMRS provider advised the Commission only months ago, the reasonableness of current interconnection prices "is further demonstrated

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[42] McCaw Comments, Docket No. 94-54, at 23-24 (Sept. 12, 1994).

[43] CTIA Comments, Docket No. 94-54, at 24 (Sept. 12, 1994). *See also* AT&T Reply, Docket No. 94-54, at 17 (Oct. 13, 1994)("The interests of CMRS providers can be protected, where necessary, through the complaint process available at the Commission or at state public utility agencies.").

[44] CTIA Comments, Docket No. 94-54, at 18 (Sept. 12, 1994).

by the relatively few complaints received by the Commission in connection with cellular/LEC interconnection arrangements."[45]

E. U S WEST's Current Arrangements Are Available to All CMRS Providers, Including New Entrants

The Commission states that there is "a significant risk that LECs may not offer new CMRS carriers interconnection agreements that are financially advantageous as those that large and incumbent CMRS providers have already secured."[46] It therefore seeks comment on whether it should require that "the same rates, terms, and conditions in existing LEC-cellular interconnection arrangements [be applied] to broadband PCS providers, or to other categories of CMRS providers."[47]

The Commission's concern is unfounded. U S WEST's interconnection charges are available to all mobile service providers: CMRS or PMRS, large or small, existing licensees or new entrants like recently licensed PCS providers. Indeed, U S WEST has already executed interconnection agreements with certain A and B block PCS licensees.[48]

U S WEST's growth discount plan is particularly attractive to new entrants, which should experience faster growth than incumbents. Incumbents, with their sizable cus-

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[45] McCaw Comments, Docket No. 94-54, at 24 n.58 (Sept. 12, 1994).

[46] Notice at 43 ¶ 90.

[47] Id. at 33-34 ¶ 70.

[48] U S WEST has also already agreed to a proposal made by one PCS licensee that, for purposes of the U S WEST growth discount plan, its PCS traffic will be combined with its cellular traffic. Of course, this ability to combine cellular and PCS traffic will be made available to all providers.

tomer bases, may be unable to sustain the 50%+ annual growth they have enjoyed in recent years. Consequently, U S WEST's growth discount plan will be very beneficial to new entrants, which should be able to take advantage of the highest refund credits.

* * *

The Commission's fear that current LEC-CMRS interconnection arrangements are unreasonable or that LECs, after a decade of CMRS interconnections, might suddenly "stymie" CMRS interconnection, is unfounded.[49] As one prominent CMRS provider has stated, "the requirement that LECs provide cost-based interconnection to CMRS providers upon demand ensures that interconnection of all CMRS customers will continue to be available."[50] Besides, "the Section 208 complaint process . . . can sufficiently protect CMRS providers against unreasonable discrimination practices by the LECs."[51]

II. EVEN IF AN INTERIM PLAN WERE APPROPRIATE, ADOPTION OF "BILL AND KEEP" WOULD BE IMPRUDENT — AND UNLAWFUL

U S WEST demonstrated above that current LEC-CMRS interconnection arrangements are reasonable and that, as a result, there is no need to adopt an interim plan — especially when this Commission must develop by August 8, 1996 interconnection

[49] Equally unfounded is the undocumented assertion that there is "a significant risk that LECs and CMRS providers [like AT&T] could engage in collusive behavior and voluntarily agree to arrangements that would not advance the public interest." Notice at 43 ¶ 90.

[50] AirTouch Comments, Docket No. 94-54, at 9 (June 14, 1995).

[51] CTIA Comments, Docket No. 94-54, at 24 (Sept. 12, 1994).

rules governing all local telecommunications carriers, including LECs and CMRS providers. However, even if adoption of an interim plan were warranted, "bill and keep" would not be appropriate. Because there is no need to adopt any interim plan, U S WEST below discusses only some of the problems with "bill and keep."

A. The Commission's Basic Assumption Underlying Its "Bill and Keep" Proposal Is Flawed

The Commission tentatively concludes that "bill and keep" can be adopted because any revenues LECs lose as a result can "be recovered from their own subscribers":

> [W]e believe that a bill and keep requirement would not deprive either LECs or CMRS providers of a reasonable opportunity to recover costs they incurred to terminate traffic from the other's network, because these costs could be recovered from their own subscribers.[52]

The Notice nowhere explains just how LECs would recover from their own subscribers revenues lost from "bill and keep." In fact, unless this Commission allows U S WEST to increase the rates for local residential service, U S WEST will not recover the losses it would sustain if "bill and keep" were adopted, even for a temporary time.

U S WEST books its Type 2 revenues entirely to intrastate accounts (because CMRS providers have not reported any interstate traffic).[53] As a result of the phenome-

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[52] Notice at 30 ¶ 62. *But see* Separate Statement of Commissioner Ness at 2 ("We must not abridge the LECs' legal or equitable rights, distort marketplace incentives for CMRS providers, or cause prices for other LEC customers to increase.")(emphasis added).

[53] *See* Section I.C.2 *supra.*

nal growth of the CMRS industry, U S WEST now realizes substantial revenues from its Type 2 connections.

"[L]ocal landline telephone service is generally priced below cost," as AT&T acknowledged recently.[54] LECs are able to subsidize local residential service because, generally at the directive of state commissions, they price other services like toll and access above cost. In this regard, U S WEST's Type 2 revenues currently generate the equivalent of 49¢ per month per local residential account.

U S WEST would lose this sizable Type 2 revenue stream if the Commission were to adopt "bill and keep." Three alternatives are available if U S WEST is to be made whole and is to replace these lost intrastate revenues from other intrastate customers:

1. Increase the rates for local residential service;
2. Increase the rates for intrastate toll service; or
3. Increase the rates for intrastate access charged to non-CMRS providers.

The second and third alternatives are problematic. U S WEST's intrastate toll and access rates already include a hefty contribution towards local service. Increasing toll rates even more to provide an additional subsidy to local service will not be successful and will, in the end, actually result in less overall funds available for subsidizing local

[54] AT&T Comments, Docket 94-54, at 10 (June 14, 1995).

rates.[55] The alternative of increasing intrastate access to non-CMRS carriers will increase substantially the disparity between CMRS and non-CMRS carriers — at a time when the Commission has determined that "functionally equivalent forms of network interconnection arguably should be available to all types of networks at the same prices."[56] Increasing intrastate access rates to non-CMRS providers will further incent these carriers to find alternative interconnection arrangements (including taking advantage of the free interconnection available to CMRS providers) — action that will further reduce existing subsidies to local service.

The only viable alternative for replacing lost Type 2 revenues, then, is to increase the rates for local residential service by approximately 50¢ per month per residential line. U S WEST does not have the ability to increase most local exchange rates, especially those for residential service, without state regulatory approval — a process which typically takes months, and a process that is rarely successful. Indeed, the resolution adopted last week at the NARUC convention suggests that state commissions will oppose increases in local rates to support free interconnection to CMRS providers.

[55] U S WEST's intrastate toll service is offered in a competitive environment, and U S WEST is already handicapped in that market because its cost structure includes a subsidy for local service when its competitors' rates do not (other than in the access they pay). Increasing U S WEST's toll rates in this environment will accelerate the loss of U S WEST's share in the intrastate toll market which, in turn, will result in even smaller revenues available to support the local subsidy. Thus, pursuing this alternative will exacerbate, rather than facilitate, the current subsidy problem.

[56] Notice at 37 ¶ 77.

Historically, this Commission has been powerless to intervene in local rate issues.[57] However, the Telecommunications Act of 1996 now empowers this Commission to intervene in local rate issues if current rates "have the effect of prohibiting the ability of any entity to provide any . . . intrastate telecommunications service."[58]

The point is, unless this Commission allows U S WEST to increase the rates of its local residential service, U S WEST will not recover lost Type 2 revenues from other subscribers, as the Commission assumes.

B. Mandatory "Bill and Keep" Is Inconsistent with the Telecommunications Act of 1996

The Commission is proposing to mandate a single compensation scheme — "bill and keep" — for all LEC-CMS interconnection. Such an order would go against the basic approach of the new Telecommunications Act, which expressly requires LECs to negotiate their terms of interconnection carrier-by-carrier.

The new federal Act orders LECs to negotiate individual interconnection agreements with each local carrier (including a CMRS provider) requesting access.[59] This

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[57] Section 2(b) of the Communications Act reserved to the States exclusive jurisdiction over rates for intrastate services like local residential service. *See* 47 U.S.C. § 152(b). *See also* Louisiana Public Service Comm'n v. FCC, 476 U.S. 335 (1986).

[58] New Section 253(a)(emphasis added). New Section 253(d) authorizes this Commission to preempt state laws and "requirement[s]" if it "determines that a State or local government has permitted or imposed any statute, regulation, or legal requirement that violates subsection (a) or (b)." Subsection (a) provides:

> No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service. 47 U.S.C. § 253(a).

[59] *See* new Section 252(a)-(c).

flexible negotiation process allows competitors to agree to efficient and mutually acceptable terms and conditions for interconnection that are tailored to their specific positions; such terms may — if the LEC and CMRS provider choose to waive their statutory rights to "mutual and reciprocal recovery" of the costs of carrying each other's calls —include a "bill and keep" arrangement.[60] Congress originally considered requiring interconnection to take place pursuant to general tariffs applicable to entire classes of interconnectors,[61] but it rejected this approach in favor of carrier-by-carrier negotiations.[62] By forcing all LECs and CMRS providers to adopt (and all states to approve) a "bill and keep" regime, the Commission would destroy the Act's flexibility by denying interconnectors and LECs the ability to vary the terms of their relationships by private agreement.

C. The Cited Factual Basis for "Bill and Keep" Is Erroneous

Certain CMRS providers have retained an economist, Gerald Brock, to support their "bill and keep" arguments. Mr. Brock makes two factual assertions in support of his recommendation of "bill and keep" for LEC-CMRS interconnection: (1) it is the mechanism found in competitive markets, as evidenced by its use within the Internet; and (2) a LEC's cost to terminate CMRS traffic is nearly zero, thereby justifying the imposition of

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[60] *See* Section 252(d)(2)(A)(i).

[61] *See* H.R. 1555, § 244.

[62] The Act does allow LECs to file "statements of generally available terms" of interconnection in each state, but unlike the Commission's proposed plan, these statements do not lock all would-be interconnectors into a single set of terms: under the Act, the statements do "not relieve a Bell operating company of its duty to negotiate the terms and conditions" of interconnection separately with each carrier requesting access. Section 252(f)(5).

free interconnection. On the basis of the foregoing, Mr. Brock represents that "bill and keep" is "the only theoretically correct basis for calculating a call completion charge."[63]

U S WEST demonstrates below that both Mr. Brock assertions are factually erroneous. Because Mr. Brock's factual assumptions are invalid, his "bill and keep" conclusion collapses.

1. The Internet Analogy Supports Asymmetrical, Not Free, Compensation Arrangements

Mr. Brock states that the goal of regulation should be "to bring the results of a monopolized or partially monopolized market closer to what would occur under competitive conditions"[64] — a proposition with which all would agree. Mr. Brock then asserts that "[t]he best existing example of interconnection under competitive conditions without regulation is the interconnection of commercial providers of Internet service."[65] According to Mr. Brock, Internet service providers exchange traffic with each other for free:

> Commercial Internet service providers agreed that interchange of traffic among them was of mutual benefit and that each should accept traffic from the other without settlements payments or interconnection charges. The CIX members therefore agreed to exchange traffic on a "sender keep all" basis in which each provider charges its own customers for originating traffic and agrees to terminate traffic for other providers without charge.[66]

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[63] Gerald W. Brock, The Economics of Interconnection, Preface (April 1995)(emphasis added).

[64] *See* id. Introduction at i.

[65] Ibid.

[66] Id. at i-ii (April 1995). *See also* Gerald W. Brock, Price Structure Issues in Interconnection Fees, at 1-2 (March 30, 1995).

On the basis of this "factual" representation, Mr. Brock concludes:

> The Internet example suggests that "sender keep all" interconnection arrangements are likely to develop in competitive communications markets as the compensation method for mutually beneficial interconnection arrangements.[67]

Mr. Brock is wrong in asserting that commercial Internet service providers exchange traffic for free.[68] Attachment B is a detailed summary of the Internet which documents that Internet providers do not exchange traffic for free. Rather, they generally follow a model of asymmetrical compensation arrangements in which smaller networks pay larger networks for the privilege of connecting to those larger networks: "Money flows upwards; Each level pays the next for connectivity and, occasionally, usage."[69]

The Internet does operate in a fully competitive environment — free from all regulation and regulatory obligations. Thus, to the extent that the Commission "adopts policies that are intended to create or replicate market-based incentives,"[70] the Internet experience suggests that this Commission should adopt asymmetrical interconnection agreements between carriers of different sizes — with money flowing from smaller carri-

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[67] Ibid.

[68] Not only is Mr. Brock wrong, but he mischaracterizes his cited source — even though that source is contained in a book he edited. As explained by Prof. Harris:

> [T]he Internet study in Brock's book noted that only voluntary members of the Commercial Internet Exchange (CIX) exchange traffic at the CIX router without settlements; it does not state that most Internet networks and providers interconnected without interconnection charges. Attachment A at 7 (emphasis in original).

[69] Kenneth Hart, "Internet Providers Want Body to Manage Growth," Communications Week International (Sept. 1, 1995).

[70] Notice at 4 ¶ 4.

ers to larger carriers. Such arrangements would reflect the elementary economic fact that smaller carriers receive more value by connecting to large carriers than *vice versa.*

2. LEC Terminating Access Costs Are Not Nearly Zero

Mr. Brock further asserts that "bill and keep" is appropriate "if either of two conditions are [*sic*] met":

> (1) Traffic is approximately balanced in each direction; [or]
>
> (2) The actual costs are very low so that there is little difference between a cost based rate and a zero rate.[71]

Mr. Brock readily acknowledges that this first condition is "rarely" met and certainly not met with the severe traffic imbalances between LECs and CMRS providers.[72] Nevertheless, Mr. Brock asserts that his second condition is present because, in his opinion, the cost a LEC incurs to terminate a CMRS call is so low that it is nearly zero. According to Mr. Brock, the cost a LEC incurs for "terminating traffic from a competitor is on average approximately 0.2 cents/minute."[73]

Mr. Brock's recommendation of "bill and keep" is thus based entirely on his opinion that an incumbent LEC's per-minute cost to terminate traffic is only one-fifth of a penny ($0.002). Mr. Brock grossly underestimates a LEC's costs because, as Prof.

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[71] Gerald W. Brock, Incremental Cost of Local Usage, at 1 (March 16, 1995)(commissioned by Cox) (emphasis in original). *See also* Gerald W. Brock, Price Structure Issues in Interconnection Fees, at 3-4 (March 30, 1995)(commissioned by Teleport); Notice at 18 ¶ 34.

[72] Gerald W. Brock, Interconnection and Mutual Compensation With Partial Competition, at 1 (Undated, prepared for Comcast Corp.).

[73] Gerald W. Brock, Incremental Cost of Local Usage, at 1 (March 16, 1995).

Harris explains in Attachment A, Mr. Brock derives his cost estimate "using several faulty assumptions."[74] Mr. Brock's omissions "not only call into serious question his $0.002 cost estimate, but also call into serious question whether 'bill and keep' would be appropriate even under Dr. Brock's stated conditions."[75]

Mr. Brock achieves his "only 0.2 cents/minute" cost estimate by engaging in two errors. First, he excludes altogether the non-incremental costs a LEC incurs in providing service, including common/overhead and embedded/legacy costs. LECs incur considerable common and overhead costs in providing their services.[76] LECs also have sizable embedded (or legacy) costs.[77] These costs are real and legitimate, and they were and are incurred on behalf of all users of a LEC's network — including CMRS providers.

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[74] Attachment A at 12.

[75] Id. at 14.

[76] Common costs are the costs associated with equipment and property used to support multiple services and customers, and include such items as switches, land, and buildings. *See, e.g.,* Bell Company Part 69 Waivers, 9 FCC Rcd 7873, 7878 (Nov. 30, 1994); Accounting Separation, 104 F.C.C.2d 59, 61 n.2 (1986). Overhead largely includes the costs of employing the people necessary to build, operate, and maintain the network. *See, e.g.,* Price Cap Review, FCC 95-393 at ¶ 41 (Sept. 20, 1995); Expanded Interconnection, 10 FCC Rcd 6375, 6376 n.4 (May 11, 1995); Expanded Interconnection, 10 FCC Rcd 11116, 11117 n.14 (Sept. 18, 1995).

[77] Embedded or legacy costs include the costs a LEC incurred to provide service in the past but which costs remain unrecovered, *e.g.,* the capital reserve deficiency. Most regulators (including this Commission) historically set depreciation rates well below economic levels to lower the rates a LEC could charge its customers. This "use now, pay later" approach worked in a monopoly environment. However, it does not work in a competitive environment.

The fact is that most LECs have a substantial capital reserve deficiency. These reserves represent costs that should have been recovered from users in the past. Since they were not recovered, as a result of regulatory policy, LECs have the right to recover them now.

Mr. Brock never explains in his papers why a LEC should be unable to recover these costs from CMRS providers. CMRS providers benefit directly by such costs; if a LEC does not incur common and overhead costs, for example, it will be unable to provide any service to anyone, including to CMRS providers. If a proportion of these costs is not recovered from CMRS providers, they must necessarily be recovered elsewhere from other network users. Mr. Brock never explains why CMRS providers, among all network users, should be exempt from paying their fair share of common and overhead costs and should, as a result, be subsidized by other users — especially when the Commission has determined that CMRS providers charge "a significant premium" for their mobile services and earn "economic rents of significant proportions."[78]

CMRS providers have also benefited, and continue to benefit, from the past universal service policies underlying low depreciation rates. The value of CMRS service is enhanced substantially when CMRS networks are connected to incumbent LEC networks because CMRS subscribers can call many more people than they could without interconnection.[79] Given this added value, it is fair and reasonable for the subscribers of interconnecting carriers to pay a share of the costs of maintaining the public switched telephone network ("PSTN"). Unless LEC shareowners earn a reasonable return on their investments, LECs will lack the means and the incentive to continue to upgrade the PSTN.

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[78] Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services, 10 FCC Rcd 8844, 8869 at ¶ 75 and 8871 at ¶ 81 (Aug. 18, 1995).

[79] It is doubtful CMRS providers would be able to impose "a significant premium" for their services without LEC interconnection.

In his papers, Mr. Brock approvingly cites an interconnection pricing study commissioned by the European Commission and prepared by, in Mr. Brock's words, "a prestigious group of European and American telecommunications experts."[80] Those "experts" emphasized that the issue of "contribution to overhead and common costs must be addressed [in interconnection pricing] as it affects the viability of the incumbent":

> Whereas the entrant's viability should, in general, not be increased by forcing the incumbent to provide interconnection below costs, the incumbent's viability may legitimately have to be safeguarded through interconnection charges above costs. Such a mark-up would be in line with the Ramsey approach already described and would have to depend on the demand relationships, the state of competition, and the seriousness of financial shortfalls.[81]

Indeed, these experts noted that "[i]nterconnection charges set at LRAIC would fail to provide contributions to the regulated firm's truly common costs and other justified revenue requirements. Therefore, mark-ups on this cost standard should be allowed . . . ."[82] As AT&T and the IXC trade association candidly stated recently:

> [A] decade of FCC decisions recognize that telecommunications services may be priced to exceed their marginal or incremental costs — and must in aggregate recover their fully distributed or average costs. The reality is that because fixed costs of telecommunications facilities are high and the marginal costs are very low, prices for telecommunications services must exceed marginal

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[80] Gerald W. Brock, Price Structure Issues in Interconnection Fees, at 2 (March 30, 1995)(commissioned by Teleport). *See also* Gerald W. Brock, The Economics of Interconnection, Introduction at ii (April 1995). Although a summary of this EC Study was published in a book Mr. Brock edited (*see* next footnote), he mischaracterizes that Study when he states that it "conclud[ed] that . . . interconnection charges should be based on the incremental cost of capacity required by the interconnector." Price Structure Issues in Interconnection Fees, at 3. *See* Attachment A at 8-11.

[81] B. Mitchell, W. Neu, K. Neumann, and I. Vogelsang, "The Regulation of Pricing of Interconnection Services," in Gerald W. Brock, editor, Toward a Competitive Telecommunications Industry: Selected Papers from the 1994 Telecommunications Policy Research Conference, at 103 (Lawrence Erlbaum Associates, 1994)(emphasis added).

[82] Id. at 113. LRAIC means long run average incremental cost.